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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

North Carolina Natural Gas Corporation,
Public Service Company of North Carolina, Inc.
Piedmont Natural Gas Company, Inc.,
Petitioners,

v.

The Public Service Commission of
The State of New York,
Long Island Lighting Company
The Brooklyn Union Gas Company, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

The decision of the U.S. Court of Appeals for the District of Columbia Circuit reversed, without remand, a Federal Energy Regulatory Commission order regarding increases in rates sought by an interstate natural gas pipeline company. After a full hearing, the Commission had found no justification for the cost allocation reflected in the pipeline's increased rates, which allocation had not been based upon any recognized cost allocation methodology, but had merely reflected a negotiated dollar accomodation in the prior rate settlement agreement specifically providing that such accommodation would not be binding on the Commission or other parties in future rate cases. The Commission therefore had ordered the pipeline to modify its increased rates to reflect an allocation of costs based upon a well-recognized cost allocation methodology. However, the Court of Appeals held that the Commission had committed an error of law in requiring the natural gas company to demonstrate the lawfulness of the cost allocation reflected in its increased rates. The questions presented are:

1. Whether the Commission may require a natural gas company to demonstrate that the rate increases which such company has sought are "just and reasonable" under the Natural Gas Act, particularly as to those aspects of such increased rates which have never previously been found just and reasonable.

2. Whether the Commission may honor provisions in a prior Commission-approved rate settlement agreement specifically stating that neither the Commission nor any other parties to such settlement will be bound in future rate cases by matters settled therein.

3. Whether, after a court of appeals concludes that the Commission has committed an error of law in a rate proceeding, such court must remand to the Commission for further proceedings and may not, in lieu of such remand, impose upon the Commission its own preferred ratemaking practice.[1]

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[1]The parties to the proceeding in the Court of Appeals are the Federal Energy Regulatory Commission, Atlanta Gas Light Company, The Brooklyn Union Gas Company, Carolina Pipeline Company, Columbia Gas Transmission Corporation, Commonwealth Gas Pipeline Corporation, Consolidated Edison Company of New York, Elizabethtown Gas Company, Long Island Lighting Company, National Fuel Gas Supply Corporation, North Carolina Natural Gas Corporation, North Carolina Utilities Commission, Philadelphia Electric Company, Piedmont Natural Gas Company, Inc., The Public Service Commission of the State of New York, Public Service Company of North Carolina, Inc., Public Service Electric and Gas Company, South Jersey Gas Company, Transcontinental Gas Pipe Line Corporation, and the Washington Gas Light Company.

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The Brooklyn Union Gas Company, *et al.*,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

North Carolina Natural Gas Corporation, Public Service Company of North Carolina, Inc., and Piedmont Natural Gas Company, Inc. (N.C. Natural, *et al.*)[2] hereby jointly petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in this cause.

[2]In accord with Rule 28.1, N.C. Natural, *et al.* state that they are corporations which have no parent companies, but which have the following subsidiaries and affiliates: Carolina Energy Company, Inc.; NCNG Exploration Corporation; Piedmont Exploration Company, Inc.; Tar Heel Energy Corporation.

OPINIONS BELOW

Neither the opinion of the Court of Appeals (Appendix A, *infra*, pp. 1-33) nor Opinion No. 59 of the Federal Energy Regulatory Commission (Appendix B, *infra*, pp. 34-53) has yet been reported.

JURISDICTION

The judgment of the Court of Appeals was entered on September 24, 1980 (Appendix C, *infra*, pp. 54-56), and various timely petitions for rehearing were denied by orders issued December 19, 1980, with the exception of the replacement of one paragraph in the Court of Appeals opinion (Appendix D, *infra*, pp. 57-59). By orders issued March 13, 18, and April 16, 1981, the Chief Justice extended the time for filing petitions for a writ of certiorari to and including May 17, 1981. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1), and Section 19(b) of the Natural Gas Act, 15 U.S.C. §717r(b).

STATUTES INVOLVED

Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§717c and 717d, set out in Appendix E, *infra*, pp. 60-63; the Administrative Procedure Act, 5 U.S.C. § 554, set out in Appendix F, *infra*, pp. 64-65; U.S. Constitution, Amendment V.

STATEMENT OF THE CASE

The Court of Appeals' opinion below reviewed certain issues regarding a wholesale rate increase filed with the Federal Energy Regulatory Commission (Commission)[3] under Section 4 of the Natural Gas Act (Act) by

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[3]Under the Department of Energy Organization Act of 1977, 42 U.S.C. §§7101, 7172(a)(1)(B), the Federal Energy Regulatory Commission succeeded (in October of 1977) to most of the

Transcontinental Gas Pipe Line Corporation (Transco), a major natural gas pipeline system serving the eastern seaboard of the United States. N.C. Natural, *et al.*[4] petition for certiorari only as to that portion of the Court of Appeals' opinion regarding the Commission's resolution of the issue as to the allocation of costs reflected in Transco's increased rates.

A. Statutory Framework

Section 4 of the Act requires that a natural gas company seeking to increase its interstate wholesale rates file new rate schedules with the Commission, as Transco did in its rate filing here at issue (Appendix E, *infra*, pp. 60-62, 15 U.S.C. §717c(d)). Under Section 4(e), the Commission may suspend the effectiveness of such new rates for up to five months, and enter upon a hearing concerning the *lawfulness* of the new rates. Section 4(a) of the Act declares that "[a]ll rates and charges [of] any natural gas company ... shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful," and Section 4(b) declares that "[n]o natural gas company shall ... (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges . . . or any other respect, either as between localities or as between

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functions and responsibilities of the former Federal Power Commission under the Natural Gas Act. The term "Commission" herein refers to either the Federal Energy Regulatory Commission or the Federal Power Commission, as appropriate.

[4]N.C. Natural, *et al.* are natural gas distribution companies which purchase natural gas from Transco and resell such gas to residential, commercial and industrial consumers within the States of North Carolina and South Carolina. N.C. Natural, *et al.* actively participate on a regular basis in Transco's wholesale rate increase proceedings at the Commission.

classes or service" (Appendix E, *infra*, p. 60, 15 U.S.C. §717c(a), (b)). At the end of the suspension period, the new increased rates may be collected, but such collection is subject to hearing and a decision in which the Commission may order the natural gas company "to refund, with interest, the portion of such increased rates or charges by [the Commission's] decision found not justified' (Appendix E, *infra*, p. 62, 15 U.S.C. §717c(e)). Further, "[a]t any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural gas company . . ." (Appendix E, *infra*, p. 62, 15 U.S.C. §717c(e)).

Section 5(a) of the Act permits the Commission to investigate rates already in effect, providing that "[w]henever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission or gas distributing company, shall find that any rate [or] charge . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate [or] charge to be thereafter observed and in force, and shall fix the same by order ***" (Appendix E, *infra*, p. 62, 15 U.S.C. §717d(a)).

B. The Commission Orders

This proceeding began on July 30, 1976, when Transco filed with the Commission pursuant to Section 4 of the Act a general wholesale rate increase wherein Transco sought to increase, *inter alia*, its contract demand (CD) rate in each of its three geographic sales rate zones.[5] The

[5]Transco's pipeline system extends from the gas production areas in Texas and Louisiana through rate Zone 1 (the states of Mississippi, Alabama and Georgia), Zone 2 (South Carolina, North Carolina, Virginia and the District of Columbia), and Zone 3 (Pennsylvania and New York).

three increased CD rates, as filed by Transco, had among them certain rate level differentials; *i.e.*, the CD-3 rate was somewhat higher than the CD-2 rate and the CD-2 rate was somewhat higher than the CD-1 rate. The uncontroverted purpose of these rate level differentials was to reflect the cumulatively higher transmission costs associated with transporting the gas the additional distance to each succeeding zone.

Rates which have zone rate level differentials directly reflecting the distance of transporting the natural gas can be developed based upon the "Mcf-mile" method of cost allocation to zones. This method allocates the pipelines' transmission costs to zones so as to produce relative rate levels which charge to the customers in each zone the same fixed transmission cost *per average mile of transport into that zone.*[6] With each general rate increase, use of the Mcf-mile method will result in an appropriate adjustment of the relative rate levels to reflect increases in the pipeline's transmission costs.

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[6]The Mcf-mile method is well-recognized in pipeline ratemaking and has been approved by the Commission and the Courts in numerous cases, particularly for long-line systems such as Transco. *E.g., Texas Eastern Transmission Corp.*, FERC Opinion No. 21 (issued August 9, 1978, in FERC Docket No. RP74-41), *vacated and remanded for further consideration* by order of February 15, 1981 in *Texas Gas Transmission Corp. v. FERC*, D.C. Cir. Nos. 79-3185 and 79-3189; *Texas Gas Transmission Corp.*, FPC Opinion No. 792 (issued April 12, 1977 in FPC Docket No. RP75-19), *vacated and remanded on other grounds, Columbia Gas Transmission Corp. v. FERC*, 628 F.2d 578 (D.C. Cir. 1979); *Tennessee Gas Transmission Co.*, FPC Opinion No. 352, 27 FPC 202 (1962); *Southern Natural Gas Co.*, FPC Opinion No. 379, 29 FPC 323 (1963) and 45 FPC 997 (1971); *Northern Natural Gas Co.*, FPC Opinion No. 281, 14 FPC 11 (1955), *aff'd sub nom. Interstate Power Co. v. FPC*, 236 F.2d 372 (8th Cir. 1956); *Kansas-Nebraska Natural Gas Co.*, FPC Opinion No. 343, 25 FPC 448 (1961).

However, the increased rates filed with the Commission by Transco in this case did not fully reflect the distance of transportation, or the increase in Transco's transmission costs. Nor were such increased rates developed using a recognized method of cost allocation, or based upon any cost responsibility analysis by the pipeline (CR. Vol. 1, 37-39, 274).[7] Rather, the proposed rates simply had the same cents-per-Mcf differentials which had been reflected in much lower rates negotiated in a rate settlement approved by the Commission in 1962.

The Commission had never found the 1962 settlement rate levels "just and reasonable" under the Act; the Commission had only approved the 1962 rate settlement as "in the public interest". *Transcontinental Gas Pipe Line Corp.*, 27 FPC 187, 189 (1962). Further, the 1962 settlement specifically had provided that none of the matters settled therein would bind the Commission or any party in Transco's future rate increase

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[7]When calculated at 100% load factor, Transco's 1962 settlement CD rates were $0.3305 per Mcf in Zone 1, $0.3505 per Mcf in Zone 2, and $0.3945 per Mcf in Zone 3 (CR. Vol. 1, 285), reflecting a 2.8 cent-per-Mcf differential between Zone 1 and Zone 2, and a 3.6 cent-per-Mcf differential between Zone 2 and 3. The rates as originally filed by Transco in this case were $1.044 per Mcf in Zone 1, $1.072 per Mcf in Zone 2, and $1.108 per Mcf in Zone 3, reflecting the *same* 2.8 cent-per-Mcf differential between Zones 1 and 2, and 3.6 cent-per-Mcf differential between Zones 2 and 3. By contrast, the adjusted Mcf-mile based rate level differentials urged by N.C. Natural, *et al.* and other parties in this case were 9.3 cents per Mcf and 13.1 cents per Mcf, respectively. An "Mcf" is one thousand cubic feet of gas, and is sometimes used interchangeably with "dth" (dekatherm), a comparable heat content-based unit of measurement. "CR" references are to the Certified Copy of Designated Portions of the Record below.

proceedings, as stated in the order approving the settlement (27 FPC at 190):[8]

> In issuing this order, the Commission's action is not to be construed as a concurrence with the . . . allocation methods and rate design principles used in arriving at rates and charges for future sales . . . and neither the Commission, its Staff, [n] or other parties to the proceedings are to be prejudiced or bound thereby in future proceedings.

By order of August 30, 1976, the Commission suspended the effectiveness of Transco's increased rates for the full statutory period, permitting such rates to take effect February 1, 1977, subject to refund, under Section 4(e) of the Act. Following an unusually long series of settlement conferences involving, *inter alia*, the question of zone rate level differentials, a settlement including an agreement to adjust the differentials was certified to the Commission for approval on May 22, 1978. However, due to the last-minute opposition of the Public Service Commission of the State of New York and Philadelphia Gas Works to the zone differential adjustment, the Commission reserved the issue and remanded the question to an administrative law judge (ALJ) for hearing.[9]

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[8]Transco's subsequent rate increase filings were also resolved in whole or in part by settlement agreements in which the Commission and the parties agreed to rates reflecting the same zone rate level differentials, but these settlements also provided that they would not bind or prejudice the parties in future rate proceedings.

[9]In the interim, Transco's rate proceeding had been "phased" for the purpose of hearing separately, *inter alia*, the rate of return issue also reviewed by the Court of Appeals (Appendix A, *infra*, pp. 26-33)

N.C. Natural, *et al.* (as well as the Commission's Staff) submitted evidence demonstrating, *inter alia*, that Transco's increased rates reflecting the 1962 settlement rate level differentials did not fairly allocate Transco's present transmission costs among the zones, and that, even if such increased rates were modified to reflect only the *same* relative allocation of transmission costs reflected in the 1962 settlement rates, the differentials would have to be nearly .ripled (CR. Vol. 1, 37-48, 58-59, 155-162, 252-254, 258-262, 284-301, 330). The N.C. Natural, *et al.* evidence supported the development of zone rate levels based upon the well-recognized Mcf-mile cost allocation methodology discussed *supra*. The Brooklyn Union Gas Company and other Zone 3 distributors sponsored evidence suggesting that Transco's increased rates reflecting the 1962 settlement rate level differentials were supportable based upon certain judgmental factors. Shortly after the conclusion of the hearing, the ALJ issued a brief initial decision concluding that, although the burden was on Transco to prove that its increased rates reflecting the 1962 rate level differentials were "just and reasonable" as required by Section 4 of the Act, the zone differentials need not be adjusted. Thereafter, N.C. Natural, *et al.* and others appealed the ALJ's decision to the Commission.

On August 6, 1979, the Commission in Opinion No. 59 reviewed the various judgmental factors raised by the Zone 3 interests to support the rates reflecting the 1962 settlement zone rate level differentials, and determined that "no adequate or proper basis had been shown to justify the continued application of [the] previously negotiated settlement rate differentials" (Appendix B, *infra*, p. 40), and that "rates resulting from the allocation of Transco's transmission costs to zones using the Mcf-mile method are just and reasonable and represent a

proper apportionment of cost responsibility between and among Transco's customers" (Appendix B, *infra*, pp. 39-40), as "distance . . . is the prime determinant of the cost of rendering service" (Appendix B, *infra*, p.51).

On September 5, 1979, various parties filed applications for rehearing of Opinion No. 59 pursuant to Section 19(a) of the Act, 15 U.S.C. §717r, along with certain motions for stay. All such applications and motions were denied by the Commission's Notice issued October 4, 1979.[10]

C. The Opinion Below

In its September 24, 1980 opinion, the Court of Appeals reversed the Commission's Opinion No. 59 without remanding to the Commission for further proceedings.

The Court of Appeals concluded that the Commission had committed an error of law in treating the proceeding as one under Section 4 of the Act because the Court believed that "[t]he zone allocations in dispute here were no part of Transco's argument for higher rates" (Appendix A, *infra*, p. 20), and therefore Transco did not bear the burden of demonstrating that its increased rates reflecting the 1962 settlement zone rate level differentials were lawful under Section 4 of the Act. The Court held that the burden was upon the Commission to investigate under Section 5 of the Act, and adjust only prospectively, those "portions of [Transco's rate increase] filing that represent no

[10]Thereafter, various petitions for review and motions for stay of the Commission's Opinion No. 59 were filed with the Court of Appeals. By order of December 11, 1979, the Court of Appeals directed that Transco put into effect a "partial" stay of the Commission's opinion, consisting of an upward adjustment in the Zone 1 and 2 rates and an escrow fund for overcollections.

departure from the *status quo*" (Appendix A, *infra*, p. 19). The Court of Appeals did not discuss the facts that the 1962 settlement provided that such zone rate level differentials would not be binding upon the Commission or others in future rate cases, or that such differentials had never been found just and reasonable on the merits.

Further, notwithstanding its finding that the Commission had committed an error of law, the Court did not remand to the Commission for further proceedings. Instead, the Court discussed at length the evidence submitted in opposition to the Mcf-mile zone cost allocation method approved by the Commission (Appendix A, *infra*, *e.g.*, pp. 11-13, 23-26), and concluded therefrom that "the record contains evidence that tends to prove the relative superiority of the zone allocation system [an apparent reference to the use of the 1962 settlement rate level differentials] as a more accurate reflection of cost incurrence" (Appendix A, *infra*, p. 26).[11]

The effect of the Court of Appeals' pronouncements as to cost allocation and refusal to remand for further proceedings would be to impose upon the Commission a finding that Transco's increased rates reflecting the 1962 settlement zone rate level differentials are "just and reasonable" under the Act.

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[11]The Court of Appeals' reference to the "zone allocation system," along with similar references throughout the opinion, suggests that the Court of Appeals believed that only the prior settlement zone rate level differentials constituted a "zone allocation". However, *both* the Mcf-mile zone rate level differentials and the prior settlement zone rate level differentials reflect zone allocations, although only the Mcf-mile differentials are the result of the application of a recognized *method* of allocation.

REASONS FOR GRANTING THE WRIT

A. The Court of Appeals' Holding That Section 5 Rather Than Section 4 Is Applicable To the Lawfulness Of Increased Rates Sought By Natural Gas Companies Raises A Question Of Importance In The Administration Of The Natural Gas Act.

The Court of Appeals' opinion presents an issue of substantial importance to the Commission's administration of the Natural Gas Act.[12] The opinion would revise the plain meaning of the Act so as to restrict severely the Commission's authority in Section 4 proceedings to modify unjust and unreasonable rate increases sought by natural gas companies, contrary to the decisions of this Court as well as the decisions of other courts of appeals. This erroneous revision of the Commission's authority would not only deny to the consumers the protection of Section 4's refund provisions but it would inject unwarranted confusion into the disposition of general rate proceedings and insure a significant increase in litigation and administrative delays, thereby increasing substantially the costs ultimately borne by natural gas consumers, contrary to the purpose of the Natural Gas Act.

Section 4 of the Act authorizes the Commission to suspend the effectiveness of a natural gas company's increased rates and to enter upon a hearing as to the lawfulness of such rates. At the conclusion of the hearing, the Commission "may, by order, require the natural gas company . . . to refund, with interest, the portion of such increased rates or charges by [the

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[12]The opinion would also affect adversely the Commission's regulation of, *inter alia*, electric utilities and oil pipeline companies under the Federal Power Act, 16 U.S.C. §§824, *et seq.* and the Interstate Commerce Act, 49 U.S.C. §§1, *et seq.*

Commission's] decision found not justified" and "the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural gas company . . ." (Appendix E, *infra*, p. 62, 15 U.S.C. §717c(e)). However, the Court of Appeals' decision would revise the plainly intended application of Section 4 in that the decision would transmogrify many of the issues which *necessarily* arise (*i.e.*, are inherent) in the determination under Section 4 of the lawfulness of increased rates, into issues which the Commission may only address in investigations of existing rates under Section 5, with relief available only prospectively, thereby depriving the consumers of the refund protection provided in Section 4.

The Court of Appeals declared that a natural gas company's burden of demonstrating that its Section 4 rate increases are lawful does not extend to those "portions of its filing that represent no departure from the *status quo*" (Appendix A, *infra*, p. 19). However, the case at bar illustrates the perverse nature of this approach when it is attempted to be applied in an actual rate proceeding. In its Section 4 filing, Transco increased each of its CD rates in each of its three zones, but the determination of the level of *each* increased rate (and, thus the *relative* levels among the rates) *necessarily was dependent upon the allocation of transmission costs underlying these rates.*

A natural gas pipeline has numerous costs, some of which at any point in time have gone up and some of which have gone down, and some of which are developed separately using various methods of determination (e.g., the company's allowed return and its depreciation expenses). All of these costs must be translated into increased rates by an allocation of costs

and a rate design. The result is that the elements of cost are reflected in an increased rate in "building block" fashion, with each cost element having grown larger (or become smaller) through cost changes and/or differences in cost determination methods *and/or greater or lesser allocations of costs to the rate.* All of these elements cumulatively support the rate level, and to this end, the Commission's Regulations require that the pipeline provide all such cost, cost allocation and rate design data in support of the justness and reasonableness of the increased rate it has filed under Section 4 (18 C.F.R. §154.63, see particularly Statement J as to cost allocation).

The Court of Appeals erred in its belief that Transco's use in its increased rates of the same cents-per-Mcf zone rate level differentials reflected in the much lower 1962 settlement rates meant that Transco was not proposing any change in the allocation of costs (Appendix A, *infra*, p.14). Transco's continued use of the same 1962 differentials in its much higher contemporary rates, reflecting its much higher present-day transmission costs, in fact effected a massive shift in the allocation of costs from Zone 3 to Zones 1 and 2 (CR. Vol. 1, 38-39, 284).

However, even if the *status quo* as to cost had been maintained by Transco's increased rates in this case, the Court of Appeals' decision would in any event gravely undermine the Commission's Section 4 authority to modify increased rates which are unlawful. The Court of Appeal's decision would permit a natural gas company to change only those elements of its rates which would tend to raise the rates (or only particular rates), while leaving unchanged those elements which would otherwise tend to lower rates, thereby relieving itself of Congress' directive that "the burden of proof to show that the *increased rate or charge* is just and reasonable

shall be upon the natural gas company" (Appendix E, *infra*, p. 62, 15 U.S.C. §717c(e), emphasis added),[13] and substituting therefor a much more limited burden of proving that only *some elements* of the increased rates are just and reasonable. In this way, increased rates which on the whole are clearly unlawful could nonetheless meet Section 4 requirements, as such requirements are interpreted by the Court of Appeals.

Since, under the rule promulgated by the Court of Appeals, any adjustment as to the unchanged elements in increased rates could be made only prospectively,[14] after a hearing in which those opposing the rates would bear the burden of persuasion, the decision would require determinations in numerous natural gas, electric and oil pipeline rate proceedings as to what portions of a proposed increase in rates must be treated as "unchanged". These initial determinations would tend to be hotly-contested, as there is no doubt that the shift of the burden of proof from the regulated company to the Commission and other opponents of the new rates would substantially change the character of rate increase proceedings to the advantage of the regulated company and/or those wishing to preserve an

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[13]The Administrative Procedure Act (APA), 5 U.S.C. §556(d) similarly directs that ". . . the proponent of a rule or order has the burden of proof" and such burden must be met by a prepondence of the evidence. *Steadman* v. *SEC*, ____ U.S. ____ (February 25, 1981).

[14]The *requirement* that any changes ordered at the conclusion of a Section 5(a) investigation be prospective is not to be confused with the Commission's *discretionary authority* under Section 4 to modify increased rates prospectively, rather than retroactively. The Commission in fact exercised such discretionary authority in this case (Appendix B, *infra*, pp. 52-53).

inequitable preference in the company's rates.[15] See *FPC v.Louisiana Power & Light Co.*, 406 U.S. 621, 642-5 (1972).

The Court of Appeals decision is also plainly in conflict with the decisions of this Court and of other courts of appeals. In *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962), the Commission had undertaken a "phased" hearing on a company's Section 4 rate increase. The Commission first had disallowed part of one cost element (an increased rate of return), thereby reducing overall rate levels, prior to determining the proper allocation of transmission costs among the rates, and thus, the proper zone rate level differentials. This phased approach had subjected the natural gas company to the possibility that, if the Commission were to modify the allocation of costs retroactively under Section 4, the company might end up having "undercollected" revenues from certain rates during the period the rates were in effect subject to refund. However, this Court found that (371 U.S. at 152):[16]

> .... [a]n analysis of the policy of the Act clearly indicates that a natural gas company initiating an increase in rates under §4(d) assumes the hazards involved in that procedure. It bears the burden of establishing its rate schedule as being 'just and reasonable.'

* * *

[15]Indeed, in this very case, a settlement to adjust the relative zone rate levels was opposed by parties urging that such a change could only be made under Section 5, prospectively after a lengthy hearing and decisional process in which N.C. Natural, *et al. and similarly situated parties bore the burden the proof.*

[16]The court of appeals there had found, exactly contrary to the decision in this case, that a ruling on zone cost allocation was an

> The company . . . may suffer further loss when the Commission upon a finding of excessiveness makes adjustments in the rate detail of the company's filing. In this latter respect a rate for one class or zone of customers may be found by the Commission to be too low . . .; on the other hand, when another class or zone of customers is found to be subjected to excessive rates . . . [t]he company's losses in the first instance do not justify its illegal gain in the latter.
>
> The company having initially filed the rates and either collected an illegal return or failed to collect a sufficient one must, under the theory of the Act, shoulder the harzards incident to its action including not only the refund of any illegal gain but also its losses where its filed rate is found to be inadequate.

Thus, where a natural gas company seeks a rate increase under Section 4, the company, not the Commission or any other party challenging the increased rates, "bears the burden of establishing its rates schedule as being 'just and reasonable' " (371 U.S. at 152), and this burden goes to *all* matters inherent in such increased rates, including the "appropriate allocation of . . . [the company's] . . . costs . . . among . . . zones and types of customers" (371 U.S. at 147).[17]

"essential element in determining whether the filed rates are excessive" under Section 4 (371 U.S. at 150).

[17]In *Ayrshire Collieries Corp. v. U.S.*, 335 U.S. 573 (1949), a case arising under similar provisions of the Interstate Commerce Act, 49 U.S.C. §15(7), this Court held that the Interstate Commerce Commission may modify not only *increased* rates, but *existing* rates merely republished by the regulated company (335 U.S. at 583):

Similarly, in *Kansas-Nebraska Natural Gas Co. v. FPC*, 534 F.2d 227 (1976), the United States Court of Appeals for the Tenth Circuit affirmed a Commission decision wherein the Commission had determined that the cost allocation reflected in a pipeline company's increased rates filed under Section 4 was not just and reasonable, and had modified such allocation retroactively under Section 4. Finding that the Commission's modification of the cost allocation was a modification of an element "inherent in the ratemaking process" (534 F.2d at 229), the Tenth Circuit rejected arguments as to the subjection of the pipeline company to undercollections due to retroactive application under Section 4 of new zone allocations, citing this Court's *Tennessee* decision, *supra*.

The Court of Appeals in this case relied heavily upon this Court's decision in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), (Appendix A, *infra*, p. 17), but that decision does not support the Court of Appeals' opinion. The question presented in *Mobile* was whether a pipeline company selling gas to a distributing company under a fixed rate contract "may, without the consent of the distributing company, change the rate specified in the contract simply by filing a new rate schedule" with the Commission under Section 4 (350 U.S. at 333-4). This Court held the Act does not give a natural gas company the right to change its *fixed-rate contracts* simply by filing a Section 4 rate increase with the Commission (350 U.S. at 377), and that such a filing is a nullity (350 U.S. 343-4):

> [The Commission] can modify the proposal in any respect and require that the proposed rates be modified or wholly different rates be substituted for the present ones. That has been the view of the Commission since the beginning, [footnote omitted] and we think it is the correct one.

> . . . [T]here is nothing in the structure or purpose of the Act from which we can infer the right, not otherwise possessed and nowhere expressly given by the Act, of natural gas companies unilaterally to change *their contracts.*

However, Transco's Section 4 general rate filing at issue here did not contravene any contract.[18] Nor was there any question raised as to Transco's right unilaterally to increase its rates.

Rather, this case simply involves the Commission's clearly-stated authority to hold a hearing on Transco's increased rates and to "order [Transco] to refund, with interest, *the portion of such increased rates or charges by [the Commission's] decision found not justified"* (Appendix E, *infra*, p. 62, §717c(e)). As this Court in *Mobile* noted with regard to Section 4 rate filings not involving fixed rate contracts (350 U.S. at 338):

> [T]he Commission may suspend the operation of the new rate pending a determination of its reasonableness,§4(e). If a decision has not been reached before the period of suspension expires, a maximum of five months, the filed rate must be allowed to go into effect, *but the Commission's order may be made retroactive to that date.*

Nor can there be any doubt that in such Section 4 proceeding, Transco "bears the burden of establishing its rate schedule as being 'just and reasonable' ".

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[18]To the contrary, it was the Court of Appeal's decision that the Commission was *required to give precedential effect to the zone differentials inherent in Transco's increased rates* that was contrary to a contract (*i.e.*, the Commission-approved settlement agreement discussed in part B, *infra*, pp. 19-26).

Tennessee, supra, 371 U.S. at 152; Appendix E, *infra,* p. 61, 15 U.S.C. §717c(e).[19]

B. The Court Of Appeals Decision Would Severely Undercut the Settlement Process As An Alternative To Extended And Costly Litigation.

The Court of Appeals' decision in this case would further hamper the Commission's efficient administration of the Natural Gas Act by severely undercutting the settlement process as an alternative to extended and costly litigation.

The Commission regulates the wholesale rates, and terms and conditions of service, of thirty-one major interstate natural gas pipeline systems (and over four dozen other non-producer gas companies), most of which file on a regular basis rate increases and other tariff changes under Section 4 of the Act.[20] Rate increase

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[19]The Court of Appeals also relied upon certain Commission language in a footnote in *Northern Natural Gas Co.,* 14 FPC 11, 19 (1955). In that case the parties had settled a Section 4 rate increase and agreed to reserve the issue of whether to establish (in effect, prospectively, see 13 FPC at 776) for the first time a zoned rate structure on the system (Appendix A, *infra,* p. 18). While N.C. Natural, *et al.* do not ascribe to the cited language, the Court of Appeals has overlooked the important differences between that case and this case. Since the pipeline there had no zones on its system prior to the Commission's decision, the Commission was required to order very substantial changes in the pipeline's rate structure and related tariff provisions, going well beyond the rate increase initially sought. Neither the Commission nor any party proposed in this case to change Transco's zoned rate structure nor the system's zone boundaries.

[20]The Commission also regulates the rates of a number of interstate oil pipeline under the Interstate Commerce Act, 49 U.S.C. §15(e)(7), and the interstate wholesale sales rates of some two hundred fifteen electric utilities under the Federal Power Act, 16 U.S.C. §824d,e, all under similar rate-change provisions.

proceedings and other tariff-change proceedings, such as curtailment of service cases, are typically very complex undertakings. Were even a significant portion of these proceedings to be litigated fully, there would be an inordinate expenditure of time, effort and very substantial sums of money, all borne ultimately by rate payers and taxpayers. See, *e.g., Pennsylvania Gas & Water Co. v. FPC*, 463 F.2d 1242, 1251 (D.C. Cir. 1972). For reasons such as these, the Congress has specifically provided in Section 554(c) of the Administrative Procedure Act (APA) (Appendix F, *infra*, pp. 64-65) that: [21]

> (c) The agency shall afford all interested parties opportunity for—
>
> (1) the submission and consideration of facts, arguments, *offers of settlement, or proposals of adjustment* when time, the nature of the proceeding, and the public interest permit; and
>
> (2) *to the extent that the parties are unable so to determine a controversy by consent,* hearing and decision on notice and in accordance with sections 555 and 557 of this title.

In FERC Order No. 32, issued June 13, 1979 in FERC Docket No. RM78-16, the Commission promulgated certain facilitating revisions in its procedures for the submission of offers of settlement, emphasizing the "importance of voluntary settlements to the orderly and expeditious conduct of its business" of administering the Natural Gas Act and the Federal Power Act, as well as the Natural Gas Policy Act of 1978, 15 U.S.C. §3301, *et*

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[21]The legislative history accompanying this provision recognizes it as being of the "greatest importance" to the functioning of the administrative process. Senate Judiciary Comm., Administrative Procedure Act-Legislative History, S. Doc. No. 248, 79th Cong., 2d Sess. 203 (1945). See also 5 U.S.C. §556(c)(6).

seq., and other portions of the National Energy Act (*mimeo.*, pp.2-3).

Not surprisingly, the courts in a great many decisions have consistently encouraged the Commission in its efforts to resolve issues by settlement. *E.g., Placid Oil Co. v. FPC*, 483 F.2d 880, 893 (5th Cir. 1973), *aff'd sub nom. Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974); *Pennsylvania Gas & Water Co. v. FPC*, 463 F.2d 1242, 1246 (D.C. Cir. 1972); *Mitchell Energy Corp. v. FPC*, 519 F.2d 36, 40 (5th Cir. 1975); *Texas Eastern Transmission Corp. v. FPC*, 306 F.2d 345, 347 (5th Cir. 1962); *Amoco Production Co. v. FPC*, 465 F.2d 1350, 1354-5 (10th Cir. 1972). However, the Court of Appeals' opinion in this case takes a decidedly wrong turn. That decision would severely undercut the vital role of Commission-approved rate and other settlements by rendering null and void certain critically important provisions commonly found therein.

Rate negotiations involve a give-and-take process wherein possible resolutions of numerous issues typically present an array of benefits and detriments to each party. A party will agree to an overall settlement "package," notwithstanding the detriments therein, if that party can be assured that its agreement as to such detriments will not come back to "haunt" it in later proceedings.[22] Prior to the Court of Appeals' decision in this case, that assurance was provided by provisions which stated that settled matters will in no way bind any of the parties or the Commission in future proceedings. Non-binding provisions such as the one the Commission had honored (but the Court of Appeals

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[22]The nature of the settlement process does not allow for the isolation of any one component of agreed-upon rates, as the D.C. Circuit itself had previously recognized. *Northern Illinois Gas Co. v. FPC*, 575 F.2d 920, 921 (1978).

disregarded) in this case have been commonplace and vitally necessary in the settlement process since the early days of Commission regulation of electric utilities and natural gas companies.

The 1962 settlement as to rates reflecting the zone rate level differentials at issue here, as well as the Transco rate settlements in the subsequent rate cases, had specifically provided that neither the Commission nor any of the parties would be bound by such settled matters in future proceedings.[23] These agreements, to have any meaning at all, necessarily constituted an agreement by the Commission and all parties that in subsequent rate proceedings all parties would be placed *in exactly the same position* as they would have been in *if there had never been a settlement* in the prior case. Thus, while Transco was not *obligated* by these settlements to file increased rates reflecting the 1962 settlement differentials, Transco, having itself *chosen* to file new rates reflecting such differentials, *a fortiori*, had the burden of justifying under Section 4 *its choice* of this particular cost allocation.

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[23]These settlements were approved by the following orders: *Transcontinental Gas Pipe Line Corp.*, 31 FPC 1150 (1964); *Transcontinental Gas Pipe Line Corp.*, 36 FPC 431 (1966); *Transcontinental Gas Pipe Line Corp.*, 46 FPC 1411 (1971); *Transcontinental Gas Pipe Line Corp.*, 51 FPC 1243 (1974); *Transcontinental Gas Pipe Line Corp.*, 54 FPC 2150 (1975); *Transcontinental Gas Pipe Line Corp.*, FPC Docket No. RP75-75, unpublished Commission Order issued January 30, 1976. The most recent settlement prior to this case had provided (Agreement As To Rates in FPC Docket No. RP75-75 dated December 2, 1975, p. 14):

> It is specifically understood and agreed that this Agreement represents a negotiated settlement and *neither Transco, the Commission, its Staff, nor any other person shall be deemed to have approved, accepted, agreed, or consented to any principle underlying or supposed to underlie* the settlement provided for herein.

While the Court of Appeals characterized the use of the fixed cents-per-Mcf zone rate level differentials since 1962 as a "settled practice" (Appendix A, *infra*, p. 14), these prior-settled differentials cannot be so characterized in either (1) the sense of a matter resolved in this case by settlement (since there was not a unanimous settlement as to the rates in this case), or (2) the sense of an issue "resolved by precedent," since the practice existed in the past *only* by the consent of the parties in Commission-approved settlements *specifically vitiating any precedential value to such consent.* Indeed, even if the Commission otherwise had the authority to treat the 1962 settlement differentials as "just and reasonable" simply by virtue of their antiquity, the Commission clearly renounced this right in approving the 1962, and subsequent, settlements. Cf. *Texas Gas Transmission Corp. v. FPC,* 441 F.2d 1392, 1395 (6th Cir. 1971).

Ignoring the non-binding character of the provisions of the 1962 settlement, the Court of Appeals erroneously elevated Transco's rates reflecting the prior settlement zone rate level differentials, which previously had been reflected only in rates approved by the Commission in settlements found "in the public interest," to the level of "just and reasonable" rates under Sections 4 and 5 (Appendix A, *infra*, pp. 24-25).[24]

[24]The Court of Appeal's analogy between this case and *Columbia Gas Transmission Corp. v. F.E.R.C.*, 628 F.2d 578 (D.C. Circ. 1979) (Appendix A, *infra*, pp. 22-23) is erroneous and does not support the proposition apparently adopted by that Court that settlement rates are *per se* equivalent to just and reasonable rates under Sections 4 and 5. Unlike the negotiated *"end result"* cents-per-Mcf zone rate level differentials in this case, the competing methods of cost classification at issue in that case (notwithstanding that one of these methods had later been adopted in a settlement) were well-recognized cost classification methodologies which had *rational bases previously tested and adopted on the merits* in other pipeline

However, there is a critical distinction between rates or a ratemaking methodology tested in a hearing and found by the Commission just and reasonable *on the merits*, and those which are solely the product of negotiation in a settlement. Cf. *Placid Oil Co.* v. *FPC*, 483 F.2d 880, 893 (5th Cir. 1973), *aff'd sub nom. Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 313-14 (1974). Consistent with this distinction, the Commission's regulations specifically provide that settlement rates are not, and could never be, deemed "just and reasonable" within the meaning of Section 4 of the Act, nor is a settlement to be accorded any precedential weight whatever (18 C.F.R. §1.18(e)(1)(iii)(A)):

> an offer of settlement shall . . . include a proposed order of the Commission accepting the settlement, which order shall include the following provision:
>
> > The Commission's approval of this settlement shall not constitute approval of or precedent regarding any principle or issue in this proceeding.

N.C. Natural, *et al.* agreed to the 1962 settlement zone rate level differentials only as part of a dollar-and-cents settlement, and only on the condition that such settlement would have no precedential effect; N.C. Natural, *et al.* most certainly would not have entered such an agreement if they had had any inkling that it would have the effect determined by the Court of Appeals. The Court of Appeals' decision would require

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proceedings. *Atlantic Seaboard Corp.*, FPC Opinion No. 225, 11 FPC 43 (1952) (the *Atlantic Seaboard* method was later endorsed in *State Corp. Comm'n v. FPC*, 206 F.2d 690 (8th Cir. 1953), *cert denied*, 346 U.S. 922 (1954)); *United Gas Pipe Line Corp.*, FPC Opinion No. 671, 50 FPC 1348 (1973), *aff'd sub nom. Consolidated Gas Supply Corp. v. FPC*, 520 F.2d 1176 (D.C. Cir. 1975).

that any party who agrees to a settlement must face future litigation in which the burden has been shifted to such party to change prior settled matters, with any such change being only prospective. It is significant that, in an attempt to avoid this chilling effect upon settlement of the Court of Appeals' decision, parties in recent settlements have included provisions attempting specifically to remove their settlements from the rule of that decision (e.g., Stipulation and Agreement approved January 29, 1981, in *Public Service Company of New Mexico*, FERC Docket Nos. ER77-464, *et al.*):

> The parties do not intend that the resolution of issues or filing requirements established in this Article III be deemed "settled practice" with regard to cost allocation or rate level as that term was interpreted by the Court in *Public Service Comm'n. of the State of New York v. FERC*, D.C. Cir. Nos. 79-2182, *et al.*, issued September 24, 1980, slip op at 14.

Finally, the Court of Appeals' decision is clearly in error as a matter of law in that it would render null and void a vital provision in a Commission-approved settlement agreement which is contrary to neither the Act nor public policy, nor is otherwise invalid or unenforceable. As the Court of Appeals for the Tenth Circuit observed in *Continental Oil Co.* v. *FPC*, 373 F.2d 96, 100 (1967):

> This court has long recognized the right of the Commission to set the scope of its proceedings and to utilize its administrative tools within the broadest of discretions, *subject only a prohibition against the denial of a specific right. Colorado Interstate Gas Co. v. FPC*, 10th Cir., 370 F.2d 777, and cases cited. But settlement agreements are encouraged for the

> very purpose of setting rights, providing for stability in the exercise of those rights, and, *unless such agreements run afoul of the Natural Gas Act or the public good,* should be interpreted to accomplish the clear and stated purpose contained therein. Such an agreement "should stand for what it says." *Texas Eastern Transmission Corp. v. F.P.C.* 5 Cir., 306 F.2d 345, 348.

Valid Commission-approved settlement agreements are *contracts* which must be honored by the Commission *(Texas Gas Transmission Corp. v. FPC,* 441 F.2d 1392, 1396 (6th Cir. 1971); *Tennessee Gas Pipeline Co. v. FPC,* 504 F.2d 199, 202 (D.C. Cir. 1974)), and which constitute property rights which may not be taken away without due process of law.[25] See *Mitchell Energy Corp. v. FPC,* 519 F.2d 36, 41 (5th Cir. 1975).

C. The Court Of Appeals, Notwithstanding Its Purported Finding Of An Error Of Law, Impermissibly Failed To Remand The Case For Further Proceedings Before The Commission.

Even if the Court of Appeals had been correct in its determination that the Commission had erred in proceeding under Section 4(e) of the Act (Appendix A, *infra,* p. 17), that Court impermissibly exceeded the bounds of judicial review by failing to remand the matter to the Commission for further proceedings not inconsistent with the Court's determination. As this Court admonished in *Idaho Power Co. v. FPC,* 344 U.S. 17, 20 (1952):

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[25]U.S. Constitution, Amendment V; e.g., *Highland v. Russell Car & Snow-Plow Co.,* 279 U.S. 253, 261 (1929).

> [T]he function of the reviewing court ends when an error of law is laid bare. At that point the matter once more goes to the Commission for reconsideration.

In lieu of such remand, the Court below proceeded to cull from the record the Zone 3 parties' evidence which the Court believed tended to support approval of the prior settlement zone rate level differentials (Appendix A, *infra*, *e.g.*, pp. 23-26). However, the Court of Appeals did not discuss the evidence of N.C. Natural, *et al. specifically addressing* the Zone 3 judgmental arguments (CR. Vol. 1, 155-162, 252-254, 258-262, 330). Such failure to review the record *as a whole* constitutes the type of misapplication and gross misapprehension of the substantial evidence test which warrants the intervention of this Court. *Universal Camera Corp. v. NLRB*, 340 U.S. 474 (1941); *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974).

Further, the Court of Appeals opinion would impose summarily upon the Commission that Court's own preferred cost allocation, contrary to this Court's admonition in *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589 (1945):

> Rate-making is essentially a legislative function. (citation omitted.) Congress to be sure has provided for judicial review of the Commission's orders (citation omitted). But that review is limited to keeping the Commission within the bounds which Congress has created. When Congress, as here, fails to provide a formula for the Commission to follow, courts are not warranted in rejecting the one which the Commission employs unless it plainly contravenes the statutory scheme of regulation.

Aside from the legal error inhering therein, there are substantial adverse practical implications to such judicial interference in the Commission's ratemaking function. The result of such interference is to establish *de facto* trial *de novo* in the courts of appeals, with far less assurance of a truly informed and expert judgment[26] and requiring yet further expenditures of time, effort and money, all ultimately burdening further the ratepayers and taxpayers.

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[26]The Court of Appeals opinion in this case contains numerous factual misunderstandings, including the Court of Appeals' apparent belief that only the prior-settlement differentials constituted "zone allocations" and, presumably, that the adoption of a Mcf-mile cost allocation would entail a change in rate form, or perhaps an elimination of zones (e.g., Appendix A, *infra*, p. 10):

> "[T]he Commission . . . ordered cost allocation not by zones but by the Mcf-mile method . . ."

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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